SUPREME COURT, U.S.

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FILED
SEP 7 1965
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IN THE

Supreme Court of the United States

October Term, 1965
No. 539

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

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BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner Bank of America National Trust and Savings Association, hereinafter referred to as the Bank, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above entitled case on May 13, 1965.

Opinions Below.

The opinion of the Circuit Court of Appeals, on the first appeal (Appendix B, *infra,* p. 5), is reported in 317 F. 2d 859. The opinion of the District Court, after trial and upon judgment for the Government (Appendix B, *infra,* p. 9), is reported in 229 F. Supp. 906. The opinion of the Circuit Court of Appeals on the second appeal (Appendix B, *infra,* p. 15), is reported in 345 F. 2d 624.

Jurisdiction.

The judgment of the Court of Appeals was entered on May 13, 1965. By order of Mr. Justice Douglas, entered August 8, 1965, time for filing petition for certiorari was extended to and including September 10, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

Question Presented.

Whether the courts below, in an action by the United States under 26 U.S.C. §6332(b) against a bank for failure, on notice of levy and demand, to surrender a deposit balance allegedly the property of a delinquent taxpayer, erred in ignoring and failing to follow the California cross-demand "compensation" statute (derived from the civil law) which, as a substantive law of property, makes existing cross-demands of the bank operate, prior to levy or demand and at the very time of deposit, automatically to pay, extinguish, and discharge the deposit obligation to the taxpayer.

Statutes Involved.

The California Code of Civil Procedure, section 440, provides:

> "When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counterclaim could have been set up, the two demands shall be deemed compensated so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other."

The third-party provision of the seizure subchapter of the Internal Revenue Code (26 U.S.C. § 6332) in pertinent part provides:

> "Surrender of Property Subject to Levy
>
> "(a) Requirement
>
> "Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate. . . .
>
> "(b) Penalty for violation
>
> "Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made. . . ."

Other pertinent provisions of the Internal Revenue Code, 1954 (Title 26, U.S.C., secs. 6321, 6322, 6323, 6331) are printed in Appendix A, *infra*, pp. 1-4.

Statement.

On April 11, 1961, the United States filed its complaint against the petitioner Bank under 26 U.S.C. §6332(b) to recover the sum of $6,658.38 for failure to surrender, upon notice of levy served August 27,

1959, and final demand September 25, 1959, funds in that amount allegedly owned by a delinquent taxpayer, one J. B. Edmondson, and on deposit in the Bank at the time of the levy [R. 1-6]. The Bank's answer denied, *inter alia*, that funds so owned by Edmondson were on deposit in the Bank at time of levy and final demand [R. 7-8]. Both parties moved for summary judgment upon stipulation of facts and the trial court entered judgment for the United States. The Court of Appeals held the stipulated facts inadequate, vacated the judgment and remanded for further proceedings (App'x B, *infra*, p. 5); *Bank of America National Trust & Savings Association v. United States*, 317 F. 2d 859 (9th Cir. 1963). Upon trial of the case [R. 33-46] after it was sent back to the trial court an opinion was filed ordering judgment for the United States [R. 21-27] (App'x B, *infra*, p. 9); *United States v. Bank of America National Trust and Savings Association*, 229 F. Supp. 906. The Court of Appeals affirmed (App'x B, *infra*, p. 15; *Bank of America v. United States*, 345 F. 2d 624).

No question of fact is involved.

Assessments and demands on taxpayer.—Withholding and F.I.C.A. taxes for the first three quarters of 1955 were assessed against the taxpayer, J. B. Edmondson, who did business under a number of fictitious firm names [R. 11]. Notices and demands for payment were timely given to, and made on, the taxpayer; notices of liens for the assessed taxes were also filed in

the recorder's office for Orange County, California, not later than January 28, 1958 [R. 9-10].[1]

Bank's lack of notice or knowledge.—Prior to August 27, 1959, no demand for payment, or actual notice, of the tax liability of the taxpayer, Edmondson, or of the liens against his property, was made or given to the Bank and, until that date, it had no actual knowledge thereof [R. 11].

Notice of levy and demand served on bank.—On August 27, 1959, the District Director served upon the Bank a notice of levy upon all property or rights to property, monies, credits and bank deposits in its possession and belonging to the taxpayer; the notice demanded payment of the amount of $12,219.09 from the amount then owing from the bank to the taxpayer [R. 10]. At the time of service of such notice of levy, and again, on service of Final Demand, September 25, 1959, the Bank refused to pay over any amount [R. 11].

Bank's records as to deposits by taxpayer.—On August 27, 1959, the books of the Bank still showed in the several commercial checking accounts and one savings account of the taxpayer credits totalling $6,658.31 [R. 11, 24].[2]

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[1]The relevant dates as to taxes for each quarter are:

1955	Date of Assessment	Notice to, and demand on taxpayer	Filing of notice of lien in Orange County
1st qtr.	July 8, 1955	July 13, 1955	Oct. 19, 1955
2nd qtr.	Sept. 20, 1955	Oct. 28, 1955	Jan. 28, 1958
3rd qtr.	Oct. 21, 1955	Nov. 8, 1955	Jan. 28, 1958

[2]This total was made up of remaining balances of checks endorsed and negotiated to the Bank for deposit by the taxpayer as follows: $560.66 deposited July 31, 1959; $378.71 deposited August 21, 1959; $160.56 deposited August 26, 1959; $5,318.38 deposited August 26, 1959; plus the sum of $240.00 in a savings account in the name of the taxpayer.

Taxpayer's obligations to the Bank.—On August 27, 1959, the day of levy and demand on the Bank, the taxpayer was indebted to the bank in the amount of $11,570.49 [R. 13, 22]. This total owing by the taxpayer to the Bank included:

A.	Five automobile conditional sales contracts, all executed by the taxpayer as purchaser, and by the vendors assigned to the Bank not later than March, 1959, total due on August 27, 1959[3] [R. 13-16]	$ 9,161.25
B.	Promissory note in amount of $1,200.00 payable June 19, 1959. Unpaid balance with interest, overdue August 27, 1959 [R. 16]	1,230.10
C.	Promissory note dated May 28, 1959, in amount of $1,284.00 payable in 12 monthly installments. Unpaid balance with interest on August 27, 1959 [R. 16-17][3]	1,179.14
		$11,570.49

Post-levy entries by Bank.—The day after receipt of notice of levy, the Bank on its books charged the deposit accounts of the taxpayer with the full amounts of their credit balances and credited the total of $6,658.31 on the obligations of the taxpayer to the Bank [R. 17].

Determinations below.—The opinion of the trial court, after quoting the California Code of Civil Pro-

[3]Defaulted installments on the conditional sales contracts totalled $743.24 and on the note (Item C) $107.00. The maturity date of the promissory note (Item B) had long since passed. Each document contained provision for acceleration of the whole liability "at option of" seller or holder [R. 13-17].

cedure, sec. 440 [R. 24], but without consideration of the decisions of the state courts construing it, holds the statute to create merely a statutory right of setoff [R. 25] that had not been exercised by the Bank at the time of levy [R. 27]. It concluded that the case was controlled by *Bank of Nevada v. United States,* 251 F. 2d 820 (9th Cir. 1957) *cert. denied* 356 U.S. 938 (1958).

In the Court of Appeals, petitioner urged that the automatic operation of the California statute left the Bank with no property of the taxpayer at time the deposits were made or any time thereafter [R. 31]. The opinion of the Court of Appeals (App'x B, *infra,* p. 16) concludes:

> "The bank seeks to distinguish this case upon the ground that in Bank of Nevada, supra, it was the levy itself which accelerated and rendered mature the obligation of the depositor to the bank, while here the obligation was mature at the time tht deposit was made and at all times thereafter. The language and rationale of the Bank of Nevada case do not permit of such a distinction. 251 F. 2d 820, 827."

Reasons for Granting the Writ.

1. *The decision of the court below conflicts with decisions of the California courts.*—The decisions of the California courts establish that under the controlling law of that state, at the time of service of the notice of levy on the bank the latter was under no obligation to the taxpayer on his deposits and the Bank held no property interest of the taxpayer that was subject to levy.

California Code of Civil Procedure, Sec. 440, provides:

> "When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counterclaim could have been set up, the two demands shall be deemed compensated, so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other."

This is no common set-off statute. It is almost unique in the United States, being derived from the civil law and traceable to the ancient Roman law of *compensatio*. It is entirely different from judicially administered set-off; it is an extra-judicial, non-volitional extinction of cross-demands. As construed and applied by the California courts the most outstanding feature of its operation is that, where cross-demands co-exist, to the extent that they are equal, they are—without agreement or even knowledge of the debtors, and at the time they first co-exist—automatically paid, discharged and extinguished. See Comment, *Automatic Extinction of Cross-Demands; Compensation from Rome to California,* 53 Calif. Law. Rev. 224, 225.

Though it appears in a Code of Civil Procedure it has long been recognized to create substantive rights. In *Iowa & C. Land Co. v. Temescal Water Co.,* 95 Fed. 320 (C.C. S.D. Calif. 1899) the court so stated and further held (p. 321):

> "The compensation for which the section provides takes place just as soon as the cross demands co-exist; the greater demand being credited with the smaller, and the latter entirely discharged."[4]

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[4]Statement in this opinion that both cross-demands must be liquidated was later overruled as mere dictum. *Sunrise Produce Co. v. Malovich,* 101 Cal. App. 2d 520, 225 P. 2d 973 (1950).

In *Jones v. Mortimer*, 28 Cal. 2d 627, 170 P. 2d 893 (1946), the court held that the automatic payment, under the statute, was available as a defense but that the claim itself was extinguished and the defense not barred by the statute of limitations. On an action commenced in 1933, plaintiff obtained judgment in 1940 for $1536 for services rendered a savings and loan association before it became insolvent. He was also a shareholder and in 1939 after its insolvency assessment of $400 was made against him but not pleaded prior to his judgment. In 1944, on his petition to enforce the judgment, the assessment was raised as a defense and he contended it was barred by the statute of limitations. The court held (pp. 632-633):

> "The cross-demands here, in the language of section 440, 'have existed between persons'—plaintiff and defendant. They existed between them at least at the time the assessment became due and the plaintiff's action on his claim was pending. They have existed under circumstances where if either brought an action thereon the other could have set up a counterclaim . . . the next step is that the demands are *compensated*. That can mean nothing more or less than that each of the claimants is *paid* to the extent that their claims are equal. To the extent that they are *paid*, how can the statute of limitations run on either of them? There is no outstanding claim on which the statute may run. It is discharged."[5]

[5]That the cross-demand takes effect as a payment, but does not continue as a claim against which the statute of limitations can run was recently recognized in the Southern District of New York, applying California law, as expounded in the *Jones* case. *King Bros. Productions, Inc. v. RKO Teleradio Pictures, Inc.*, 208 F. Supp. 271, 278 (1962).

In *Hauger v. Gates,* 42 Cal. 2d 752, 269 P. 2d 609 (1954) plaintiff, purchaser of a ranch, sued to set aside a foreclosure sale held when he defaulted on a deed of trust note. He contended there was no default because the seller had failed to deliver personal property to which plaintiff was entitled under the contract of sale. Demurrer was sustained. In reversing, the California Supreme Court ruled (p. 755)—

> ". . . plaintiffs were not in default at the time of the sale. Section 440 is explicit in stating that the co-existing cross-demands shall be 'compensated so far as they equal each other,' which necessarily means that each of the claimants is *paid* to the extent that their claims may be balanced in amount."

That the California statute regards the cross-demands as discharged—so far as equal—from the moment they first co-exist is also clear from *Pan Pacific Sash & Door Co. v. Greendale Park, Inc.,* 166 Cal. App. 2d 652, 333 P. 2d 802, 807. There the trial court had entered judgment for the difference between plaintiff's demand and defendant's counterclaim but interest for the full amount of plaintiff's demand, apparently on the theory that the counterclaim damages amount was not established until trial. The District Court of Appeal modified the judgment to allow interest only on the amount of the judgment from the stipulated date of commencement of interest. Citing the statute and *Jones v. Mortimer, supra,* it said (p. 807):

> "Thus to the extent that appellants had a right to offset against respondent's claim the amount of damage sustained by reason of the delivery of defective materials plaintiff's claim *was satisfied.*

Appellants *never* owed plaintiff $16,271.41 but only $12,535.96 for which the court awarded judgment." (Emphasis supplied).

2. *The decision below is in conflict with decisions of this Court.*—In failing or refusing to consider and give effect to the California court decisions construing the California Code of Civil Procedure, section 440, the decision of the Court below violates the rule laid down by this Court. That the issue of "no property rights" raised by the bank here must be first determined as a matter of state law was recognized by this Court in *United States v. Bess,* 357 U.S. 51, 55 (1958) and most clearly reiterated in *Aquilino v. United States,* 363 U.S. 509, 512-513 (1960):

> "The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had 'property' or 'rights to property' to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that 'in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute' ".

United States v. Durham Lumber Co., 363 U.S. 522, 526, reaffirms this important rule of decision.

Careful examination of the California law to determine what property rights of the taxpayer were subject to seizure in the hands of the Bank is equally important here as was such examination of the New York law in the *Aquilino* case.

3. *The judgments below are not entitled to the weight customarily given to lower court determinations of state law.*—The trial court quotes California Code of Civil Procedure, Sec. 440, upon which petitioner relies [R. 24] but calls it a mere "statutory right of set set-off under state law" [R. 25]. The opinion discloses no basis for this conclusion; neither does it reflect consideration of the pertinent state court decisions. It appears rather to give controlling weight to the ruling in *Bank of Nevada v. United States,* 251 F. 2d 820 (9th Cir. 1958), cert. denied 356 U.S. 938 (1958) [R. 25]—

> "that Federal tax liens and the provisions for their collection are strictly *Federal* and strictly *statutory* . . ."[6]

Neither can the judgment of the Court of Appeals reasonably be given the weight customarily attached by this Court to determinations of issues of state law made by a court skilled in the law of the particular state. A *per curiam* opinion (App'x B, *infra,* p. 15) can scarcely be said to demonstrate the requisite careful scrutiny of the state court decisions. Again, of the sitting judges, none was a California lawyer. *Cf. Ragan v. Merchants Transfer & Warehouse Co.,* 337 U.S. 530, 534 (1949); *Estate of Spiegel v. Commissioner,* 335 U.S. 701, 707-708 (1948).

4. *The question of state law here involved is one of general and continuing importance.* In their lending operations, banks rely to a great extent upon the existence of compensating deposit balances of borrowing

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[6]The *Bank of Nevada* case was decided four months prior to the decision in *United States v. Bess,* 357 U.S. 51.

customers.[7] Banks lend upon the total assets of a borrower. The right to use compensating deposit balances is fundamental to sound credit practices, and has with the growth of the number and types of relationships between banks and borrowers, become increasingly important. The confusion resulting from the instant case in which the Ninth Circuit Court disregards the general rules pronounced by the Supreme Court on the meaning of "property and rights to property" under section 6323 of the Revenue Code of 1954 thus seriously impairs the credit functions of banks. It is therefore of utmost importance, and in the public interest, that this court resolve the conflicts and settle once and for all the question here involved.

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[7]Where a bank has no actual knowledge of the tax lien, its mere existence, whether or not recorded, imposes no duty on the bank not to make payments to the depositor from the deposits to which the lien has attached. *United States v. Eiland*, 223 F. 2d 118, 122 (4th Cir. 1955); *United States v. Sullivan*, 333 F. 2d 100, 114, n. 26 (3d Cir.) 1963; *United States v. Jacobs*, 155 F. Supp. 182, 190 (D. N.J. 1957); *United States v. Polan Industries, Inc.*, 196 F. Supp. 333 (S.D.W. Va. 1961); Rev. Rul. 56-48 (Cum. Bull. 1956-1, 561); Rev. Rul. 57-367 (Cum. Bull. 1957-2, 846). Plumb, *Federal Tax Collection and Lien Problems*, 13 Tax L. Rev. 247, 310.

[8]Even apart from the very special self-operating cross-demand provisions of section 440 of the California Code of Civil Procedure which were not involved in *Bank of Nevada, supra*, the rulings of the Ninth Circuit in *Bank of Nevada* and in the instant case are contrary to the decisions in other Circuits upholding the right of setoff in the face of a federal tax lien. *United States v. Bank of Shelby*, 68 F. 2d 538 (5th Cir. 1934); *United States v. Bank of United States*, 5 F. Supp. 942 (S.D.N.Y. 1934); *United States v. Long Island Drug Co.*, 115 F. 2d 983 (2d Cir. 1940); *Karno Smith Co. v. Maloney*, 112 F. 2d 690 (3rd Cir. 1940); *In re Halprin*, 280 F. 2d 407 (3rd Cir. 1960).

Conclusion.

It is submitted that the writ of certiorari should be granted in order to review the judgment of the court below or, in the alternative, to vacate and remand for more careful determination of the property rights of the petitioner and the taxpayer-depositor under applicable state law.

Respectfully submitted,

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APPENDIX A.

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that any accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1958 ed., Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1958 ed., Sec. 6322)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of lien without notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated,

whenever the State or Territory has by law designated an office within the State or territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) *Form of notice.*—If the notice filed pursuant to subsection (a)(1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) *Exception in case of securities.*—

(1) *Exception.*—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

(2) *Definition of security.*—As used in this subsection, the term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

* * * * *

(26 U.S.C. 1958 ed., Sec. 6323)

SEC. 6331. LEVY AND DISTRAINT.

(a) *Authority of Secretary or Delegate.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d)) of such officer, employee, or elected official. If the Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and

demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

(b) *Seizure and sale of property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personel, tangible or intangible).

(c) *Successive seizures.*—Whenever any property or right to property upon which levy has been made by virtue of subsection (a) is not sufficient to satisfy the claim of the United States for which levy is made, the Secretary or his delegate may, thereafter, and as often as may be necessary, proceed to levy in like manner upon any other property liable to levy of the person against whom such claim exists, until the amount due from him, together with all expenses, is fully paid.

(26 U.S.C. 1958 ed., Sec. 6331.)

APPENDIX B.

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Bank of America National Trust & Savings Association, a National Banking Association, Appellant, vs. United States of America, Appellee. No. 18,142. May 24, 1963.

Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Chambers and Barnes, Circuit Judges, and Weigel, District Judge.

Chambers, Circuit Judge:

J. B. Edmondson in August, 1959, was a customer of the Bank of America at its West Orangethrope Road office in Fullerton, Orange County, California. Credit balances owed him by the bank on August 27, 1959, which, if there were no liens or set-offs, all would agree, amounted to $6,658.31.

Dating from 1955 to and including August 27, 1955, the government (the Internal Revenue Service) had balances due from the bank's customer Edmondson in excess of eight thousand dollars plus interest on three assessments made in 1955 for deficiencies in taxes for that year, either payroll withholding or F.I.C.A. (i.e. social security) payable in 1955 for the first three quarters thereof. The process of making the assessments, notifying the taxpayer Edmondson of the assessments and filing notices of lien in the recorder's office of Orange County, California, was all completed by January 28, 1958. Then on August 27, 1959, the date

herein mentioned at the outset, the District Director of Internal Revenue served a notice of levy upon the bank upon "all property or rights to property belonging to" Edmondson. Thereafter a final demand was made upon the bank. This was refused and on April 11, 1961, the United States sued the Bank of America for its book balances of $6,658.31 as of August 27, 1959, in favor of Edmondson.[1]

Very promptly and on August 28, 1959, the bank proceeded to protect itself by asserting a right of set-off against Edmondson. It made bookkeeping entries disposing of the customer's previous balance of $6,658.31 as follows:

1.	On "boat mortgage" indebtedness of Edmondson to the bank	$1,130.68
2.	On unsecured note	1,230.10
3.	On four of five conditional sales contracts assigned by Edmondson to the bank	4,297.53[2]
	Total	$6,658.31

The question of the case is whether the bank's self-help here was grounded on its legal right under applicable statutes, or did the federal levy get in between Edmondson's rights against the bank and the bank's rights against Edmondson.

After a "Pre-trial Stipulation of Facts and Statement of Contentions and Issues" was signed by the

[1]The sequence of how Edmondson acquired the balances in accounts for a total of $6,658.31 is set forth in an affidavit which accompanied the bank's motion for summary judgment.

[2]The asserted set-off did not fully satisfy the claimed balance on the fourth conditional sales contract and did not reach the fifth.

parties, each made a motion for summary judgment for the sum of $6,658.31. The trial court granted the government's motion. The bank appeals.

We have here a case which is obviously related to our case of Bank of Nevada v. United States, 251 F.2d 820, but as of now one has difficulty in determining whether it is a sister case or a case of third cousins twice removed. The trouble is in the stipulation and pre-trial order.

The exact nature of Edmondson's liability to the bank under the conditional sales contracts (apparently the seller's ends of the contracts were assigned to the bank) is not shown. The debt on the boat is described as "boat mortgage." The note is described as "unsecured note." Where reference is made to the conditional sales contracts two items of $132.33 and $52.14 called "unearned time price differential" are inserted. In simple English one can assume this pretty phrase means "unearned interest."

This court is not satisfied that the stipulation tells clearly how or when the balances became due. The bank thinks it is clear enough one way. The government does not agree and thinks it clear another way.[3]

The court is of the opinion that the stipulation just does not tell enough "who, what, when, where and how" for the trial court or this court to make a definitive

[3]During oral argument approximately an hour was spent by the court in colloquy with counsel as to what the stipulation should be. Counsel had diverse but positive notions. The court was in doubt as to the basic facts on the claimed offsets.

ruling. There is enough chance of error if the facts are fully developed.

It would appear that there still is little likelihood of a dispute as to the actual facts and that the matter could be handled on a more comprehensive stipulation. Certainly a stipulation should include and could be entered into as to copies of all the bank records and documents showing how and when the liability of Edmondson to the bank came about. Eventually it may be decided that the contents of the conditional sales contracts, the boat mortgage, and the unsecured note are not too important. But let the court decide that.

The judgment along with the findings and conclusions of the trial court are vacated. The case is remanded for proceedings consistent with the foregoing opinion. See Plastino v. Mills, 9 Cir., 236 F.2d 32.[4]

(Endorsed) Opinion. Filed May 24, 1963.

Frank H. Schmid, Clerk.

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[4]Plastino v. Mills, supra, is a case at the other end of the spectrum. There a simple story was expanded into on overlong and confused discourse which at points was within itself contradictory. But in both cases, Plastino and Bank of America, the stipulation or pre-trial order can be said to be not sufficiently definitive.

Opinion of the United States District Court, for the Southern District of California, Central Division.

United States District Court for the Southern District of California, Central Division.

United States of America, Plaintiff, v. Bank of America National Trust and Savings Association, a national banking association, Defendant. No. 426-61-TC Civil.

Filed May 18, 1964.

This action involves priority of claims to funds in a taxpayer's bank accounts. The United States asserts a lien right; and the defendant bank asserts a statutory right of setoff. There is no dispute as to the facts, both parties having moved for summary judgment.

The taxpayer, J. B. Edmondson, maintained accounts with defendant bank at a branch office in Fullerton, Orange County, California. The accounts stood in the taxpayer's own name and in certain business names. For aught that appears in the record, the businesses were sole proprietorships. The accounts have been treated by the parties as being those of the individual taxpayer, and this Court shall so treat them.

The taxpayer became indebted to the United States for withholding and F.I.C.A. (Social Security) taxes for the first, second and third quarters of 1955. Notices of the various assessments were given, and demands for payment made of the taxpayer, in accordance with applicable provisions of the Internal Revenue Code. Notice of lien for the first assessment was filed in

Orange County, California, October 19, 1955; notices as to the two other assessments were filed in Orange County January 28, 1958.

On August 27, 1959, the district director of Internal Revenue served upon defendant a notice of levy upon all property or rights of property belonging to the taxpayer. By this notice, demand was made of defendant for $12,219.09, this being a portion of the amount defendant then owed the taxpayer. Defendant had no actual knowledge of the existence of the assessments, nor of any United States tax lien against the taxpayer's property, prior to service of this notice.

The district director served final demand upon defendant September 25, 1959. Defendant has refused to pay any of the amount to the Government.

On the date of the notice of levy, the taxpayer's accounts with defendant bank showed total credits of $6,658.31. This figure included amounts credited to Edmondson for deposits during the preceding 30 days of part of the proceeds of various checks drawn on other banks. At the time of such levy, the taxpayer was indebted to the bank in the amount of $11,570.40 upon the following instruments:

> Conditional sale contract, dated March 18, 1958, for purchase of an automobile, which contract was assigned by the seller to defendant March 26, 1958.
>
> Conditional sale contract, dated March 19, 1959, for purchase of an automobile, which contract was assigned by the seller to defendant March 19, 1959.

Conditional sale contract, dated March 20, 1959, for purchase of an automobile, which contract was assigned by the seller to defendant March 20, 1959.

Conditional sale contract, dated September 5, 1958, for purchase of an automobile, which contract was assigned by the seller to defendant September 5, 1958.

Conditional sale contract, dated December 10, 1958, for purchase of an automobile, which contract was assigned by the seller to defendant December 10, 1958.

Promissory note, dated April 21, 1959, payable to the order of defendant, in the amount of $1,200.00, which instrument was payable on demand, or, if no demand were made, on June 19, 1959.

Promissory note, dated May 26, 1959, payable to the order of defendant, in the amount of $1,284.00, secured by a mortgage upon a boat.

With exception of the demand note, each of these instruments contained an acceleration clause providing that in the event of default, all sums unpaid should, at the option of the creditor, immediately become due and owing.

As of the date of the levy, no demand had been made for payment of the demand note, nor had any payment been made thereon. On each of the other instruments there was an installment past due which had not been paid.

The day following the notice of levy, the bank made bookkeeping entries charging the taxpayer's accounts with the sum of $6,658.31 (the entire amount on de-

posit) and crediting this sum against the balances due on the various instruments as follows:

A. On conditional sale contracts for cars:

Car	Balances due 8-27-59	Credit Given for Unearned Portion of Finance Charges	Distribution of $6,658.31	Balances After Entries
1959 Chev.	$1,853.68	$132.33	$1,721.35	ϕ
1959 Ford	2,125.14	52.14	2,073.00	ϕ
1957 Cad.	2,842.02		367.88	$2.474.14
1959 Ford	2,205.12		none	2,205.12
1956 Ford	135.30		135.30	ϕ
	$9,161.25	$184.47	$4,297.53	$4,679.26
B. On boat mortgage:				
	$1,179.14	$ 48.46	$1,130.68	ϕ
C. On unsecured note:				
	$1,230.10		$1,230.10	ϕ
		Total:	$6,658.31	

The Government claims a prior right under Internal Revenue Code §§ 6321, 6322, 6323, 6331 and 6332, governing liens for taxes and enforcement thereof. Defendant relies principally upon California Code of Civil Procedure § 440:

> *"Counterclaim; compensated demands; effect of assignment or death*
>
> "When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counterclaim could have been set up, the two demands shall be deemed compensated, so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other."

The Court views this case as being controlled by the decision in *Bank of Nevada v. United States,* 251 F. 2d 820 (9th Cir. 1957), *cert. denied,* 356 U.S. 938 (1958), notwithstanding that defendant herein relies on a statutory right of setoff under state law, while in the *Bank of Nevada* case reliance was on a "general lien or right of setoff." As the Court pointed out in that case, at p. 824:

> "The Supreme Court has repeatedly and emphatically stated that Federal tax liens and the provisions for their collection are strictly *Federal* and strictly statutory. . . .
>
> * * *
>
> "Section 6332(a) [of the Internal Revenue Code] gives the appellant [bank] only two defenses; namely, (1) that it was not in possession of property of the taxpayer which was subject to levy; or (2) that the property was subject to a prior judicial attachment or execution. The statute admits of no other defenses." (Emphasis in quoted material.)

While this in itself was sufficient to defeat the claim of the defendant in the *Bank of Nevada* case, the court went on to point out the Government's claim arose before any right under the instruments held by the bank. The same is true in the present case.

In the *Bank of Nevada* case, the defendant's claim was based upon a demand note similar to one of the instruments here. The Court of Appeals noted the bank's right of setoff arose only subsequently to and as a result of the tax levy, and hence the bank did not have priority.

Defendant argues with some ingenuity the bank was purchaser of certain checks, part of the proceeds of which were deposited to the taxpayer's various accounts during the 30 days preceding the levy, and consequently the lien is not valid against defendant under Internal Revenue Code § 6323. That section provides that the lien shall not be valid "as against any mortgagee, pledgee, purchaser, or judgment creditor" until notice has been filed.

Here the Government did not seek to levy upon any property purchased by the bank (i.e., the checks) but rather upon the defendant's debt to the taxpayer. Nor did the Government levy upon mortgaged property, although the bank was a mortgagee.

It is inconceivable that, by § 6323, Congress meant to say if a bank or other entity became a purchaser or a mortgagee in one transaction, funds held by it as a result of another transaction (i.e., creation of a debtor-creditor relationship in respect to a bank deposit) would be beyond the reach of the Government in a proceeding such as this.

Nor do we find persuasive the defendant's argument that the taxpayer himself, being indebted to the bank, could not demand payment on his accounts and therefore the Government could not demand such payment. While the bank asserts it had a right of setoff, it had not exercised this right as of August 27, 1959.

Plaintiff shall have judgment against defendant in the amount of $6,658.31, together with interest as provided by law, and costs.

Dated: This 18th day of May, 1964.

Thurmond Clarke
United States District Judge

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Bank of America National Trust and Savings Association, a national banking association, Defendant-Appellant, vs. United States of America, Plaintiff-Appellee. No. 19,469.

[May 13, 1965]

On Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Pope, Merrill and Browning, Circuit Judges

Per Curiam:

This appeal presents the question whether a Government tax levy[1] upon the taxpayer's checking and savings accounts prevails over an existing indebtedness from the taxpayer to the bank.[2]

Assessment for delinquency against the taxpayer was made by the Director in 1955. Notices of tax lien were recorded in 1955 and January, 1958. Obligations of the taxpayer to the bank arose by virtue of various loans made commencing in March of 1958. The amounts here involved were deposited to the taxpayer's accounts prior to August 27, 1959. Notice of levy was served on the bank on August 27, 1959. At that time the taxpayer was in debt to the bank in the sum of $11,570.49. His

---

[1]Under Int.Rev.Code of 1954, §§6331 (Levy and Distraint) and 6332 (Surrender of Property Subject to Levy).

[2]The opinion of this court on a prior appeal is reported at 317 F. 2d 859 (1963). The District Court's opinion on the remand from which this appeal is taken is reported at 229 F.Supp. 906 (S.D.Cal. 1964).

bank accounts then amounted to $6,658.31. The day following the Government levy, by bookkeeping entry, the bank credited the amount in the taxpayer's accounts against the taxpayer's indebtedness to the bank.

The District Court, in holding for the Government, ruled that this case is controlled by our decision in *Bank of Nevada v. United States,* 251 F.2d 820 (9th Cir. 1958), *cert. denied,* 356 U.S. 938 (1958). We agree.

The bank seeks to distinguish this case upon the ground that in *Bank of Nevada, supra,* it was the levy itself which accelerated and rendered mature the obligation of the depositor to the bank, while here the obligation was mature at the time the deposit was made and at all times thereafter. The language and rationale of the *Bank of Nevada* case do not permit of such a distinction, 251 F.2d 820, 827.

Judgment affirmed.

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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 539

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Brief of California Bankers Association, Amicus Curiae, in support of Petitioner's Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. .....

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Brief of California Bankers Association, Amicus Curiae, in support of Petitioner's Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

By consent of petitioner, Bank of America National Trust and Savings Association, and of respondent, United States of America, filed herewith, California Bankers Association files this brief as amicus curiae.

STATEMENT OF INTEREST OF THE AMICUS CURIAE

The amicus curiae, California Bankers Association, is a nonprofit organization the membership of which includes most of the commercial banks active in the State of Cali-

fornia. In their lending operations, California banks rely upon the fact that borrowers maintain deposits with the lending bank and upon the lending bank's common law and distinctive statutory right to set off a borrower's deposit against his indebtedness. In reliance upon that right, banks in this State have for many years looked to a borrower's deposit as a form of security for their loans.

This litigation involves a determination of whether that right may be effectively nullified by a federal tax lien. If permitted to stand, the decision of the court below would cast upon lending banks the burden of a borrower's tax liability and would substantially impair the credit activities of banks in California. Accordingly, this action is of vital concern to the banking industry in this State.

ARGUMENT

1. The Decision of the Court of Appeals Is in Conflict with the Decision of Other Courts of Appeal on the Same Matter

As noted on pages 8-11 of the petition, California Code of Civil Procedure, Section 440 is almost unique in providing for the automatic extinction of cross-demands, without the necessity of a volitional exercise of a right of set-off. Even apart from such a provision, however, courts of other circuits have long upheld a creditor's right of set-off against a federal tax lien in the circumstances presented by this case.

In *United States v. Bank of Shelby,* 68 F.2d 538 (5th Cir. 1934), a federal tax lien was held subordinate to a bank's common law right of set-off against a borrower's deposit despite the fact that the Government had notified the bank of its intention to levy upon that deposit prior to the time the bank asserted its pre-existing right of off-set. The court reasoned that on the day such notice was given:

> ". . . the bank could either at law or in equity have defeated a demand by . . . [its debtor], of the money apparently to his credit by offsetting the note which produced the credit, and the United States can only claim under and through him and subject to the defenses and equities affecting him. Debts thus in origin and in equity joined together could not by lien or levy be put asunder. . . ." (68 F.2d at 540.)

Similar facts were involved in *United States v. Bank of United States,* 5 F. Supp. 942 (S.D.N.Y. 1934). In upholding the defendant bank's common law right of set-off, the court stated:

> "It would be most unfair that a third person, merely by reason of his interposition, whether he was a sovereign or not, should be able to change the rights inter sese between the obligor of the chose in action and his obligee, who is the objective of the levy or attachment." (5 F. Supp. at 945.)

The court expressly noted that the depositor had been permitted to withdraw funds from its account until the time of notice of levy, ruling that its use of the account was in the nature of a revocable license and not a property right to which the Government's lien could attach.

Later decisions in other circuits are in accord. See,

United States v. Long Island Drug Co., 115 F.2d 983 (2d Cir 1940);

Karno-Smith Co. v. Maloney, 112 F.2d 690 (3d Cir. 1940);

United States v. Guarantee Bank & Trust Co., 56 F. Supp. 470 (E.D.N.C. 1944);

Transmix Concrete of Rochdale v. United States, 142 F. Supp. 306 (W.D. Tex. 1956);

In re Halprin, 280 F.2d 407 (3d Cir. 1960);

United States v. Raley Contracting Co., 210 F. Supp. 54 (N.D. Miss. 1962).

Each of those decisions has an *a fortiori* application in jurisdictions recognizing the automatic extinction of cross-demands. The ruling of the court below is in conflict with those decisions, and that conflict should be resolved by this Court.

2. The Court of Appeals Has Decided an Important Question of Federal Law Which Has Not Been, but Should Be, Settled by the Supreme Court

This Court has never directly decided the issue presented in this case. The importance of the right of off-set to the banking community has already been noted on pages 12-13 of the petition and in the amicus curiae's Statement of Interest. That right is also basic to numerous relationships in addition to that of bank and borrower-depositor, such as that of bailor and bailee, landlord and tenant, shipper and carrier, and contractor, owner and subcontractor. In fact, it is basic to any situtation involving two or more parties with mutual monetary obligations. In view of these considerations, of the increasing number of federal tax liens being filed each year, and the uncertainty now existing in the law, it is of utmost importance that this Court resolve that issue once and for all.

3. The Decision of the Court of Appeals Is in Conflict with Applicable Decisions of the Supreme Court

Although this Court has not directly decided the question presented, it has ruled that the determination of whether the taxpayer possesses property to which a tax lien can attach must be decided in accordance with applicable state law. The court below did not decide that question in accordance with California law and its ruling is, therefore, in conflict with the rulings of this Court.

The rule that state law is controlling on the question of whether the taxpayer has any interest in property to which

a tax lien can attach has been enunciated by this Court in various contexts, commencing with its decision in *United States v. Bess,* 357 U. S. 39 (1958). In that case, the Court considered the liability of a beneficiary of an insurance policy upon the life of a deceased taxpayer against whom a tax lien existed. The Court stated that since Section 3670 of the Internal Revenue Code of 1939 [Section 6321 of the 1954 Code] "creates no property rights but merely attaches consequences, federally defined, to rights created under state law, *Fidelity & Deposit Co. v. New York City Housing Authority,* 241 F.2d 142, 144, we must first look to . . . [the taxpayer's] right in the policies as defined by state law." (357 U. S. at 55.)

In *United States v. Brosnan,* and *Bank of America N.T. & S.A. v. United States,* 363 U. S. 237 (1960), it was held that a subsequent federal tax lien could, after default on a prior mortgage or deed of trust, be divested by a judicial sale or by a private sale pursuant to the terms of the instrument. In reaching this conclusion, the Court adopted state law governing divestiture of federal tax liens as federal law, in order to avoid "severe dislocation to local property relationships." (363 U. S. at 242.) The Court also reaffirmed the rule of the *Bess* case.

That rule was again applied in *Aquilino v. United States,* 363 U. S. 509 (1960), in which a subcontractor sought to enforce a mechanic's lien and to impress a trust upon funds held by a general contractor against whose property a federal tax lien was asserted. The Court stated that the threshold question in *every* case in which the federal government asserts its tax lien is whether and to what extent the taxpayer has property to which the tax lien can attach. "In answering that question, both federal and state courts must look to state law . . ." (363 U. S. at 512.)

That principle was reaffirmed once again in the latest Supreme Court decision on this question, *United States v. Durham Lumber Co.*, 363 U. S. 522 (1960).

The court below failed to give effect to those decisions of the California Supreme Court which have construed California Code of Civil Procedure, Section 440.[1] It thereby violated the principle established by the *Bess, Brosnan, Aquilino* and *Durham Lumber* decisions.

CONCLUSION

For the foregoing reasons, it is submitted that the writ of certiorari should be granted in order to review the judgment of the court below, or in the alternative, to vacate and remand for more careful determination of the property rights of the petitioner and the taxpayer-depositor under applicable state law.

Dated: October 5, 1965.

Respectfully submitted,

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1. The lower court regarded its prior decision in *Bank of Nevada v. United States*, 251 F.2d 820 (1957), *cert. denied*, 356 U.S. 938 (1958), as controlling in this case. But the *Bank of Nevada* case arose out of transactions occurring in the State of Nevada, not California. So far as the amicus curiae can determine, Nevada law does not recognize the automatic extinction of cross-demands as provided by California Code of Civil Procedure, Section 440. In reaching its decision the court below ignored that basic difference between the law of California and Nevada.

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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 539

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 15–16) is reported at 345 F. 2d 624. The earlier decision of the court of appeals, vacating a judgment in favor of the United States and remanding to the district court (Pet. App. 5–8), is reported at 317 F. 2d 859. The opinion of the district court on remand (R. 21–27; Pet. App. 9–14) is reported at 229 F. Supp. 906.

JURISDICTION

The judgment of the court of appeals was entered on May 13, 1965. On August 8, 1965, Mr. Justice Douglas extended the time for filing a petition for a

writ of certiorari to and including September 10, 1965. The petition was filed on September 7, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a bank may defeat a levy upon the taxpayer's bank accounts by a claim to a setoff for a debt incurred after the federal tax lien was recorded.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 6321. [26 U.S.C. 6321] LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 6331. [26 U.S.C. 6331] LEVY AND DISTRAINT.

(a) *Authority of Secretary or Delegate.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a

lien provided in this chapter for the payment of such tax. * * *

(b) *Seizure and Sale of Property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

* * * * *

SEC. 6332. [26 U.S.C. 6332] SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) *Requirement.*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for Violation.*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy.

* * * * *

Code of Civil Procedure, 14 West's Annotated California Codes:

§ 440. *Counterclaim; compensated demands; effect of assignment or death*

When cross-demands have existed between persons under such circumstances that, if one had brought an action against the other, a counterclaim could have been set up, the two demands shall be deemed compensated, so far as they equal each other, and neither can be deprived of the benefit thereof by the assignment or death of the other.

STATEMENT

The United States brought this action under Section 6332(b) of the 1954 Code (*supra*, p. 3) to collect the amount of a tax levy served on petitioner pursuant to Section 6332(a) (*supra*, p. 3). The government's complaint alleged (R. 3–6),[1] and the trial court found, that at the time of the levy, petitioner held property of taxpayer J. B. Edmondson which was subject to prior federal tax liens. On the first appeal, the court of appeals reversed on the ground that the stipulation as to the facts was inadequate (Pet. App. 5–8). On remand, a fuller stipulation of facts was agreed to and the district court again found in favor of the government (R. 8–18, 21–27). The court of appeals affirmed *per curiam* (Pet. App. 15–16).

On various dates in 1955, federal withholding and Federal Insurance Contributions Act taxes were as-

[1] "R." refers to the printed record in the court below in No. 19,469.

sessed against J. B. Edmondson, of which $8,374.44 remained unpaid at the time of trial. The taxpayer was served with notice and demand for payment of such taxes, and notices of federal tax liens were duly filed in Orange County, California, on October 19, 1955, as to the assessment for the first quarter of 1955, and on January 28, 1958, as to the assessments for the second and third quarters of 1955 (R. 9–10). On August 27, 1959, the District Director served petitioner with a notice of levy and a demand for payment of all amounts petitioner was then holding in the taxpayer's checking and savings accounts, to the extent of unpaid taxes (R. 10). On the date of the levy, petitioner's books showed that the taxpayer had deposits to his credit in several commercial checking accounts and one savings account totaling $6,658.31 (R. 11). The commercial accounts were active accounts, into which deposits were made and upon which checks were drawn by the taxpayer up to the date of the levy (R. 12–13).

On August 27, 1959, the taxpayer was indebted to petitioner in the amount of $11,570.40 on several notes. All of these notes were executed after January 28, 1958, the date the latest notices of federal tax liens were filed (R. 13–17). On August 28, 1959, the day after receiving the notice of levy, petitioner made entries on its books purporting to credit the $6,658.31 balance then standing in the taxpayer's checking and savings accounts against his obligations under the notes (R. 17).

Petitioner defended its refusal to make the payments demanded in the government's levy on the ground,

among others,[2] that the amounts shown on its books to the taxpayer's credit on the date of levy had been automatically extinguished at the instant of deposit by operation of California Code of Civil Procedure § 440 (*supra*, p. 4), and that, therefore, the deposits were no longer in existence on August 27, 1959. Relying primarily on *Bank of Nevada* v. *United States*, 251 F. 2d 820 (C.A. 9), certiorari denied, 356 U.S. 938, the district court, on two occasions,[3] and the court of appeals rejected petitioner's contention.

ARGUMENT

This case presents only a question of California law, which was correctly decided in the courts below. Petitioner contends that, under California law, it had no "property [or] rights to property" belonging to the

[2] Petitioner has abandoned any claim that it was entitled to actual notice of the federal tax liens before making the loans to the taxpayer as well as any claim to a banker's lien under California Civil Code § 3054.

[3] The first opinion of the district court, which is unreported, reads in pertinent part as follows:

> Counsel for defendant Bank have made a strong argument in the face of a difficult set of facts. Acceptance of the position they have advocated, however, would result in a situation where, by virtue of state law, California banks could gain advantage by purposely avoiding procedures that would inform them of preexisting federal tax liens, such as the examination of county lien records. California banks, by avoiding notice, could make loans and accept deposits subsequent to the filing of federal tax liens and then, even after notice of levy of the tax lien, could effect a setoff without any liability to the federal government. This result could not be reached under the reasoning of *Bank of Nevada* v. *United States*, 251 F. 2d 820 (9th Cir 1957). * * *

taxpayer at the time of the government's levy. There is no contention, as indeed there cannot be, that a bank account in California is not the kind of property which is subject to a lien under Section 6321 of the 1954 Code (*supra*, p. 2). See *MacKenzie* v. *United States*, 109 F. 2d 540, 542 (C.A. 9). Nor does petitioner appear to dispute the proposition that the right to a setoff for debts arising after the recording of a federal tax lien does not take priority over the lien.[4] See *e.g.*, *Bank of Nevada* v. *United States*, 251 F. 2d 820, 824–827 (C.A. 9), certiorari denied, 356 U.S. 938; *United States* v. *Graham*, 96 F. Supp. 318 (S.D. Calif.), affirmed *per curiam sub nom. California* v. *United States*, 195 F. 2d 530 (C.A. 9), certiorari denied, 344 U.S. 831. Its contention basically is that California Code of Civil Procedure § 440 is not "a mere 'statutory

[4] Petitioner asserts (Pet. 13, n. 8) that the decision below and that in *Bank of Nevada* conflict with decisions "upholding the right of setoff in the face of a federal tax lien." But none of the cases relied on are apposite here. In *United States* v. *Bank of Shelby*, 68 F. 2d 538 (C.A. 5), and *United States* v. *Bank of United States*, 5 F. Supp. 942 (S.D.N.Y.), the setoff rights were for debts which arose and matured before the federal tax lien was recorded. *United States* v. *Long Island Drug Co.*, 115 F. 2d 983 (C.A. 2), held a tax lien subordinate to a later-arising debt on the theory that the tax lien could not attach to future earnings. This Court expressly disapproved that theory in *Glass City Bank* v. *United States*, 326 U.S. 265, 267. In *Karno-Smith Co.* v. *Maloney*, 112 F. 2d 690 (C.A. 3), as well as *Aquilino* v. *United States*, 363 U.S. 509, and *United States* v. *Durham Lumber Co.*, 363 U.S. 522, also cited by petitioner, it was held that a defaulting contractor acquired no interest in payments due under the contract against which the government asserted a tax lien. Similarly, *In re Halprin*, 280 F. 2d 407 (C.A. 3) held that the taxpayer acquired no interest in payments under a contract until the party financing the work had been paid.

right of setoff under state law'" (Pet. 12) but is "an extra-judicial, non-volitional extinction of cross-demands" (Pet. 8).

We submit that the courts below, and not petitioner, have correctly apprehended the California law applicable to this case. Petitioner seeks to disparage the district court's application of Section 440 by noting that the court described the provision as a "statutory right of setoff" (Pet. 12), but the California courts have described the provision in the same terms. See, *e.g.*, *Ainsworth* v. *Bank of California*, 119 Cal. 470, 475, 51 Pac. 952, 953 ("our statute of setoff"); *Murchison* v. *Murchison*, 219 Cal. App. 2d 600, 605 (Dist. Ct. App.) ("[t]his principle of setoff"); cf. *Salladin* v. *Mitchell*, 42 Neb. 859, 862, 61 N.W. 127, 128 (construing substantially identical Nebraska statute). The fact that Section 440 is derived from the civil law and is traceable to the Roman law of *compensatio* (Pet. 8) does not preclude its application in the same manner as an equitable setoff so far as the issue involved here is concerned. To the contrary, the civil law developed a specific restriction on *compensatio* to the effect that a bank may not automatically extinguish a general deposit and credit it against a past due note. See Comment, *Automatic Extinction of Cross-Demands:* Compensatio *From Rome to California*, 53 Calif. L. Rev. 224, 276; Comment, *The Right of a Bank Depositor in Louisiana To Compensate His Debt to the Bank*, 8 Tul. L. Rev. 423, 427 & n. 26.

It is well settled in California and elsewhere that the right to setoff, under Section 440 or on general

equitable principles, does not defeat third parties' otherwise superior interests in the property claimed to have been set off or "compensated." *Keck* v. *Keck*, 219 Cal. 316, 26 P. 2d 300 (alimony rights); *Roberts* v. *Spires*, 195 Cal. 267, 232 Pac. 708 (subcontractors' liens); *Walters* v. *Bank of America National Trust & Savings Association*, 9 Cal. 2d 46, 54–57, 69 P. 2d 839 (garnishment); *United States* v. *Graham*, 96 F. Supp. 318 (S.D. Calif.), affirmed *per curiam sub nom. California* v. *United States*, 195 F. 2d 530 (C.A. 9), certiorari denied, 344 U.S. 831 (tax liens); cf. *Middle Atlantic Credit Corp.* v. *First Pennsylvania Banking & Trust Co.*, 199 Pa. Super. 456, 185 A. 2d 818 (factors' liens). None of the California cases cited by petitioner involved third-party interests, but the comprehensive law review comment on Section 440 relied on by petitioner (Pet. 8) expressly recognizes that "[f]unds subject to liens may not be compensated away" (53 Calif. L. Rev. at 276) and accepts the district court's decision in the case at bar as wholly consonant with California law on the limitations of Section 440 (*id.* at 277).

Petitioner's contention that the taxpayer's deposits were extinguished at the instant they were made is belied by the fact that the deposits continued to appear on petitioner's books and the taxpayer continued to use his accounts after his deposits were made and his obligations to petitioner were in default. The crucial determination for federal tax lien purposes is whether, at the time of the levy, the deposits were in reality being held in the taxpayer's accounts. Conceptual extinction of the deposits under the doctrines

of compensation and relation back is of no consequence here. *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 50; *United States* v. *Allen*, 328 F. 2d 377 (C.A. 5).

There is no substance in petitioner's assertion that the decision below will have a serious adverse effect on California banks. The banks are not embarrassed in any respect by the present decision. At the most, the decision might lead them to inquire into the existence of tax liens before extending credit.[6] The primary effect of the decision below is to afford the United States the same right as any private lien creditor to priority over banks' later-arising claims to their customers' deposits. The reading petitioner seeks to give Section 6340, on the other hand, would result in impossible bookkeeping problems for banks and their borrower-customers. See Comment, *supra*, 53 Calif. L. Rev. at 276.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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OCTOBER 1965.

[6] In the present case, the loans made by petitioner to the taxpayer were, for the most part, secured by prime liens on new property, purchased under conditional sales arrangements, in which only the taxpayer's equity is subject to federal tax liens.

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IN THE

Supreme Court of the United States

October Term, 1965
No. 539

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, a national banking association,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

REPLY BRIEF OF PETITIONER.

I.

Comment Upon the Position of the United States.

The respondent, United States, in its brief, distorts the record and the argument of the petitioner Bank in an attempt to make it appear that the courts below deemed applicable and carefully reviewed the law of California and came to the conclusion that the construction of Section 440 of the California Code of Civil Procedure contended for by the Bank is not supported by the appellate decisions of the California courts.

The lower courts did not concern themselves with the law of California. Both the trial court and the

Ninth Circuit took the position that the decision in *Bank of Nevada v, United States*, 251 F. 2d 820 (9th Cir. 1957) which involved a Nevada transaction was determinative of this matter. (App'x. B, Pet. p. 16.) There is no discussion in the opinions below, or in fact, any mention of any decisions of the California appellate courts on the subject.

The only conclusion that can be drawn is that the Ninth Circuit has in effect taken the position that the entire question is a question of federal law and has refused to follow the decisions of the Supreme Court under Section 6323 of the Revenue Code of 1954 dealing with "property and rights to property".

It is true that the federal tax liens were recorded prior to the times when the obligations of the taxpayer Edmondson to the Bank were incurred. Federal tax liens, however, only attach to "property and rights to property". The basic position of the Bank is that there was never a moment when the taxpayer Edmondson had any "property or rights to property" in the bank deposits to which federal tax liens could attach. Under the applicable law—the law of California—the obligation of the Bank to Edmondson was no more than to pay to him or his order a debt equal in dollar amount to the deposits *provided* he first discharged his obligations to the Bank.

II.

Argument.

The effect of Section 440 of the California Code of Civil Procedure is clearly defined by the California Supreme Court in *Jones v. Mortimer,* 28 Cal. 2d 627, 170 P. 2d 893 (1946) and *Hauger v. Gates,* 42 Cal. 2d 752, 269 P. 2d 609 (1954). Under these decisions, Section 440 of the California Code of Civil Procedure is no ordinary set-off statute. These cases, in effect, are rulings that to the extent that cross-demands exist, they are automatically deemed paid, discharged and extinquished. In other words, under California law, cross-demands automatically compensate each other. No action to effect an offset is required of the parties. By operation of law, one claim offsets the other. To paraphrase a statement of this court, the words of the California Supreme Court have become the words of the California statute. *National Association for the Advancement of Colored People v. Button,* 371 U.S. 415, 432 (1963). These key California cases were completely ignored by the courts below and in the brief of the United States. Under such circumstances, can it possibly be said that this case involves only a question of California law which was correctly decided in the courts below? Our first point is that there was no real consideration of the California law in the courts below. They attempt to hide behind the label "set off" rather than determine the exact effect of Section 440 of the California Code of Civil Procedure as determined by the California appel-

late decisions. This necessarily follows from the fact that the lower courts rested on *Bank of Nevada* which had nothing to do with the law of California.

The United States, in its brief, cites the 1897 California Supreme Court case of *Ainsworth v. Bank of California,* 119 Cal. 470, 51 P. 552 (1897) apparently because in the decision, Section 440 of the California Code of Civil Procedure is referred to as a set-off statute. Other cases such as *Murchison v. Murchison,* 219 Cal. App. 2d 672, 33 Cal. Rptr. 383 (1963) appear to be cited for the same reason. There is nothing inconsistent in these decisions with the rulings of the California Supreme Court in *Jones* and in *Hauger.* Unlike earlier California cases, *Jones* and *Hauger* state how the offset or compensation is accomplished under Section 440 of the California Code of Civil Procedure. The United States does not meet the argument of the Bank by ignoring these definitive decisions or by suggesting, without citing any case in support thereof, that the effect of Section 440 of the California Code of Civil Procedure is different where a bank account[1] or the rights of a third party are involved.

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[1]The footnote in 8 Tulane Law Review 423 referred to in the brief of the United States purports merely to set forth the opinion of the student writer as to the law of Louisiana and France. Law review articles as to the "civil law" and decisions of other jurisdictions and to other or even similar statutes even if we were to indulge in the invalid assumption that they represent the weight of authority—are irrelevant. As to the California statutes the federal courts are bound by the interpretation of the California Supreme Court. *Marine National Exchange Bank v. Kalt-Zimmers Mfg. Co.,* 293 U.S. 357, 363; *United States v. Combest,* 286 U.S. 424, 427.

The United States says (Br. 9) that the crucial question is "whether, at the time of the levy, the deposits were in realty being held in the taxpayer's accounts."[2] The problem whether the alleged debtor holds "property rights" subject to levy is not to be determined by mere labels. Neither is the test whether the deposits were being "held in the taxpayer's account". (Gov. Br. p. 9). As this court held in *United States v. Bess,* 357 U.S. 51, 55-56 (1958), the existence of the requisite "property" under state law is to be determined by ascertaining whether the taxpayer had rights to enjoinment that could be enforced by the taxpayer under the state law. We say therefore, the crucial question is whether the taxpayer had under California law a legal right at any time to the deposits as against the Bank.

As far as *Bank of Nevada* is concerned, there is no statute in Nevada similar to Section 440 of the California Code of Civil Procedure.[3] Besides, *Bank of Nevada* is distinguishable upon the facts, is basically wrong in concept, and should be overruled because it is

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[2]In *United States v. Bank of United States,* 5 F. Supp. 942 (S.D.N.Y. 1934) the Court ruled that the fact that the taxpayer was permitted to use the account up until the time of the levy was not determinative and that in effect the bank had merely given the taxpayer a revocable license to use the account.

[3]The Court in *Bank of Nevada* makes no mention of *United States v. Bank of Shelby,* 68 F. 2d 538 (5th Cir. 1934) or *United States v. Bank of United States, supra,* both of which were decided in 1934 and are directly contrary to the position taken by the Court in *Bank of Nevada.* The United States attempts to distinguish these cases on the basis that the indebtedness owing the bank arose prior to the recording of the Federal tax liens. In *Bank of Shelby,* the deposits were made on June 8, 1925, and on June 18, 1925 the tax lien levy was made and offset effected. The deposit against which the offset was made was the

basically inconsistent with the subsequent decisions of the Supreme Court in the line of cases beginning with *United States v. Bess, supra.*[4]

The importance of the question to California banks is attested to in the amicus brief filed on behalf of the California Bankers Association in support of the Bank's petition. It is of utmost importance that this Court settle once and for all the question here involved. There is no basis whatsoever for the statement that a favorable decision to the Bank would result in impossible bookkeeping problems for banks as is suggested by the United States in its brief.

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result of a loan transaction entered into on June 8, 1925. The decision in no way turns upon the fact that there were indebtednesses of the taxpayer to the bank which antedated the recording of the federal tax lien. Surely, the federal tax lien could not have attached at any time prior to the deposit on June 8, 1925. The same basic factual situation is found in *United States v. Bank of United States, supra.*

[4]On August 27, 1959 the date of the levy in the instant case, there was due on the matured indebtednesses of the taxpayer Edmondson to the Bank an amount in excess of the monies on deposit in the bank accounts. In *Bank of Nevada,* the court reasoned that there was no showing that any sum was due until after the levy when an attempt was made to accelerate the indebtedness on the basis of an acceleration agreement and financial statement of the taxpayer filed with the Bank of Nevada. It was argued that the indebtedness was evidenced by a demand note, but this argument was rejected by the court on the ground that the note was payable "on demand; if no demand is made then on August 14, 1955," and that such an obligation is not a true demand note which is due from its date but becomes due only upon actual demand or upon the specified date. Levy in that case was made prior to August 14, 1955 and no demand was made until after the levy. In short, *Bank of Nevada* involved a situation where the court in effect took the position that there was no evidence whatsoever that the monies were due from the bank customer and taxpayer to the bank at the time of the levy or any time prior thereto. On the other hand, the United States, in the instant case, upon whom the burden of proof rests, has failed to prove that there was ever a time when the taxpayer Edmonson could

III:
Conclusion.

It is submitted that the writ of certiorari should be granted in order to review the judgment of the court below or in the alternative to vacate and remand for a more careful determination of the property rights of the petitioner and the taxpayer-depositor under the applicable state law.

Respectfully submitted,

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insist upon the bank paying to him the deposits in question without first discharging his indebtednesses to the bank. In *Bank of Nevada,* the court speaks of the taxpayer's inchoate agreement relative to acceleration. Here, we are not concerned with any inchoate agreement. First in time, first in right, has nothing to do with the matter. We are involved with the threshold question what, if any, were the property and the property rights of the taxpayer.

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IN THE

Supreme Court of the United States

October Term, 1965
No. 539

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Rehearing of Order Denying Petition for Writ of Certiorari.

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IN THE

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No. 539

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

Petition for Rehearing of Order Denying Petition for Writ of Certiorari.

Petitioner, Bank of America National Trust and Savings Association prays that this Court grant rehearing of its Order of November 22, 1965 denying the petition for a Writ of Certiorari and that a Writ of Certiorari issue to review the judgment of the Court of Appeals for the Ninth Circuit in the above-entitled case as prayed for in the petition filed September 7, 1965 herein.

Reasons for Granting Rehearing and Issuing the Writ.

The argument of the government in the instant case is gutted by a decision published after the petition and the briefs were filed herein. We refer to the case of *United States v. National Bank of Commerce* (U.S. Dist. Ct., East Dist. La. Oct. 15, 1965) 65-2 USTC Par. 9720. A copy of the opinion as it appears in the

Advance Sheets, Standard Federal Tax Reports (Commerce Clearing House) is appended hereto. At time of printing of this Petition for Rehearing, the case was not yet officially reported.[1]

The Louisiana District Court decision repudiates the government's contention that the civil law "compensation" does not apply to bank deposits. A major premise in the government's Brief in Opposition (Br. 8), based upon a student comment in the Tulane Law Review, is that the principle of "compensation", derived from the civil law, does not apply to bank deposits. Quite to the contrary is the Court's ruling in *National Bank of Commerce*.[2] There the Court, Ainsworth J., was concerned with a Louisiana "compensation" statute similar to Sec. 440 of the California Code of Civil Procedure. The statute, Article 2207, LSA-Revised Civil Code, reads in pertinent part as follows:

> "When two persons are indebted to each other, there takes place between them a compensation that extinguishes both the debts, in the manner and cases hereafter expressed."[3]

A notice of federal tax lien had been filed and a levy made upon the bank. The Court applied the "compen-

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[1]The decision did not come to the attention of counsel for Petitioner until November 19, 1965. A letter to the Clerk apparently arrived too late to be considered by the Court in acting on our Petition, denied November 22, 1965. As appears from the attached opinion an attorney from the Tax Division, Department of Justice participated in the case, and the decision was entered October 15, 1965, 13 days before the government filed its brief herein.

[2]Of course, a forty-year California Supreme Court decision is also to the contrary. *Arnold v. San Ramon Valley Bank*, 184 Cal. 632, 194 Pac. 1012 (1921).

[3]The self-operating feature of the Louisiana Statute is fully recognized in *Arkansas Natural Gas Corporation v. Sartor*, 98 F. 2d 527 (5th Cir. 1938).

sation" statute of Louisiana to find the bank's deposit obligations discharged and concluded the bank therefore held no property or right to property when the levy was made. In addition, resting upon the foregoing statute it distinguished the rule of *Bank of Nevada v. U.S.*, 251 F. 2d 820 (9th Cir. 1957), as inapplicable where the statutory principle of "compensation" (in Louisiana, as in California derived from the civil law) has at the time of levy already extinguished the taxpayer's property right by operation of law. Thus, stated the court:

> "While the foregoing reasons are sufficient to decide this case, we find that the bank's plea of compensation (setoff) is likewise well taken. The United States, relying on *Bank of Nevada v. United States,* 9 Cir. 1958, [58-1 USTC Par. 9228], 251 F. 2d 820, cert. den., 356 U.S. 938, 78 S. Ct. 780 (1958), contends that NBC did not exercise its right of setoff until after the government's levy was served on it. *Bank of Nevada* is inapplicable to the facts here because Louisiana law does not require exercise of setoff, but it occurs through 'compensation' by operation of law. The claim of the United States in *Bank of Nevada, supra,* was based on an agreement which gave the bank the option of setoff under certain specified contingencies.
>
> "In Louisiana, the claim of setoff is treated in civilian terminology as 'compensation.' Compensation is defined in Article 2207, LSA-Revised Civil Code:
>
> 'When two persons are indebted to each other, there takes place between them a compensation that extinguishes both the debts, in the manner and cases hereafter expressed.'

"Compensation occurs in Louisiana by the mere operation of law even unknown to the debtors. See Article 2208, LSA-Revised Civil Code. Therefore, even if we treated the payrolll and general accounts as to entirely separate accounts the defendant would still prevail under the Louisiana provisions for legal compensation, and the credit in one account would be extinguished by the overdraft debit in the other."[4]

So likewise, Sec. 440 of the California Code of Civil Procedure is a self-operating "compensation" statute.[5]

The Court, in *National Bank of Commerce,* recognizes that there is no magic in the word "setoff" and that if the decisions of this Court are to be given any weight, the threshold question requires a determination of the effect of the "compensation" (offset) statute of the state where the transaction has occurred. Thus, concluded the Court:

"*Bank of Nevada, supra,* was based on the court's rejection of the bank's contention that as a 'general rule' a bank has a 'general lien' upon deposits. There is no inchoate agreement here, nor is the defendant, NBC, claiming a general lien under some elusive general rule. The bank asserts a legal right afforded to it by virtue of law and it was not necessary for it to do some positive act in order to protect this right, for as we have seen in Louisiana Civil Code Article 2208, legal compensation takes place 'even unknown to the parties.' "

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[4]It is not impertinent to note that this decision was written by a judge thoroughly familiar with state law. Judge Ainsworth was in the active practice of law in Louisiana for thirty years before his appointment in 1961.

[5]*Jones v. Mortimer,* 28 Cal. 2d 627, 170 P. 2d 893 (1946); *Hauger v. Gates,* 42 Cal. 2d 752, 269 P. 2d 609 (1954).

There is thus a conflict between the two courts as to the applicability of *Bank of Nevada* where a state statute provides for automatic "compensation," offset, and discharge of bank liability to the taxpayer. *National Bank of Commerce* underlines the need for an authoritative decision by the Supreme Court on the effect of state "compensation" laws on Sec. 6332 levies. We are not dealing with isolated transactions. Federal tax lien levies on bank accounts are everyday occurrences. The Ninth Circuit in the instant case rested upon *Bank of Nevada*—a case which has nothing to do with Sec. 440 of the California Code of Civil Procedure or any other "compensation" statute.[6] In effect, therefore, the Ninth Circuit, contrary to *National Bank of Commerce* and decisions in other Circuits, is saying that the property and property right decisions of the Supreme Court relative to federal tax liens do not apply to bank accounts. Surely, California banks should not be subjected to such discrimination. Justice and the need for uniformity dictates that the matter should be settled by the Supreme Court.

We know this Court does not sit to correct mere error. But this Court has repeatedly held assertion of a section 6332 levy penalty to require determination, *in limine,* and as matter of state law, whether the defendant held "property" of the taxpayer at the time of the levy.

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[6]The government's brief significantly ventures no forthright reliance on *Bank of Nevada* to support the Ninth Circuit's decision here involved. Instead, it seeks by allusion, to "recording" of lien and "[f]unds subject to liens" (Br. in Opp., pp. 7, 9) to confuse the issue as one of "priority", thus lightly skipping over the "threshold" question: Whether the bank was "in possession of * * * property or rights to property upon which a levy has been made." (Sec. 6332).

If this Court's decisions are to be other than academic for the future, then this Court must continue to exercise its supervisory powers when, as here, a lower court fails to give even formal consideration to state court decisions establishing the effect of the state law.

Conclusion.

For the reasons set forth above and in the Petition for a Writ of Certiorari. it is respectfully urged that rehearing be granted and that a Writ of Certiorari issue to the Court of Appeals for the Ninth Circuit to review the judgment below or in the alternative to vacate and remand for a more careful determination of the property rights of the petitioner and the taxpayer-depositor under the applicable state law.[7]

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Of Counsel.

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[7]A further alternative is to defer action on this petition for rehearing until time for appeal in the *National Bank of Commerce* case has expired; and, if appeal is timely noted, until decision on appeal, thus preserving petitioner's rights if this Court insists on conflict of circuits. *Cf. Stone v. White,* 296 U.S. 550; 298 U.S. 646; 299 U.S. 622; 300 U.S. 643; 301 U.S. 532.

Certificate of Counsel.

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58 of the Rules of this Court.

ROBERT H. FABIAN,
Counsel for Petitioner.

APPENDIX.

[¶9720] United States of America, Plaintiff v. National Bank of Commerce, Defendant.

U. S. District Court, East. Dist. La., New Orleans Div., No. 15250, Civil Action Division, 10/15/65.

[1954 Code Sec. 6323]

Lien for taxes: Bank deposits: Property.—Where a taxpayer maintained two accounts with a bank, one of which was overdrawn in excess of the amount in the second account, the bank held no property of the taxpayer upon which the Government could levy for taxes. Back reference: ¶5362.032.

Sherin V. Reynolds, Tax Division, Department of Justice, Washington, D. C. 20530, Louis C. LaCour, United States Attorney, Ernest N. Morial, Assistant United States Attorney, New Orleans, La., for plaintiff. Louis C. Guidry, 920 National Bank of Commerce Bldg., New Orleans, La., for defendant.

Ainsworth, District Judge: This case involves a claim by the United States against the National Bank of Commerce (hereafter called NBC) for judgment against the defendant in the sum of $814.79 for the latter's refusal to honor an Internal Revenue tax levy served upon it, against funds of one of its customers claimed to be on deposit in the bank.

Both parties have moved for summary judgment under Rule 56, Fed. R. Civ. P., and there is no genuine issue as to any material fact. These motions are before us for determination.

On September 20, 1963 plaintiff made assessments against the Quality Construction Company, Inc. (here-

after called taxpayer) for corporation income taxes due for taxable periods in 1959 and 1960 for $7,062.26 and $337.74, respectively. On the same date plaintiff demanded payment from taxpayer who failed to pay.

On February 4, 1964 a notice of tax lien relative to the assessment was filed with the Clerk of Court in Jefferson Parish, Louisiana, taxpayer's domicile. On February 7, 1964 a notice of levy together with a copy of the tax lien were served by plaintiff on NBC, in which bank taxpayer maintained a general account and a payroll account. At that time taxpayer's payroll account showed a credit of $814.79, but the general account was overdrawn $1,516.94. The defendant bank contends that the credit in the payroll account was subject to the overdraft of $1,516.94 in the general account and therefore the bank was not in possession of any property belonging to the taxpayer.

Plaintiff contends that on the date of the service of its tax levy on the bank, the bank possessed funds belonging to the taxpayer in the amount of $814.79, which is subject to its lien. (See 26 U. S. C. A. § 6332.)

The bank's position in essence is that the general and payroll accounts of the taxpayer, Quality Construction Company, are in fact one account; that for the convenience of its corporate customers such as Quality, it maintains two accounts. This banking practice is verified by the affidavit of the manager of NBC's branch office where taxpayer maintained its account.[1] There-

[1]Mr. Belloni, the manager, states in his affidavit:
"That in order to facilitate the handling of payrolls by some of the customers of the Bank, it is usual to have the customer open two separate accounts, one known as the General Account, and the other as the Payroll Account. That it is possible for one of the accounts to become overdrawn through various reasons

fore, if the two accounts are maintained merely for the customer's convenience, and are treated as one account for banking purposes, the operation of debiting or crediting either account against the other is merely a bookkeeping transaction. The overdraft in one account merely represents a debit to be made in the second account. The entire transaction is handled as if both accounts represented the debit and credit columns of a single account. Accordingly, when the levy was served upon the defendant the taxpayer's net account showed a credit of $814.79 and a debit of $1,516.94, which means that there was a deficit in the account and the taxpayer was actually indebted to the bank for $702.15, the net overdraft. Thus, the bank is correct that it did not possess any property or rights to property subject to the government's levy.[2]

While the foregoing reasons are sufficient to decide this case, we find that the bank's plea of com-

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and such overdrafts approved for payment upon consideration of the balance in the other account and the merit of the principals involved. Especially is this true where the persons authorized to sign on each account are the same persons as was the case in this instance."

[2]The debit against the payroll account was not made until February 21, 1964, after the tax levy was made against the bank. However, this delay is explained by Mr. Belloni in his affidavit. On the date the levy was served a deposit was made by taxpayer consisting of two checks for $10,212.48 and $45.44, respectively. This was on Friday, and there was no clearing date until the following Monday, February 10, 1964, at which time the check for $10,212.48 was returned because it had not been properly signed by the drawer. The bank waited before making its debit entry to the payroll account; believing that taxpayer would procure the proper signatures and redeposit the check. However, by February 21, 1964 the affiant was convinced that the taxpayer did not intend to cover the overdraft in the general account by redepositing the $10,212.48 check. Affiant then authorized the debit to the payroll account and credit to othe general account for $814.79.

pensation (setoff) is likewise well taken. The United States, relying on *Bank of Nevada v. United States,* 9 Cir. 1958, [58-1 USTC Par. 9228], 251 F. 2d 820, cert. den., 356 U.S. 938, 78 S. Ct. 780 (1958), contends that NBC did not exercise its right of setoff until after the government's levy was served on it. *Bank of Nevada* is inapplicable to the facts here because Louisiana law does not require exercise of setoff, but it occurs through "compensation" by operation of law. The claim of the United States in *Bank of Nevada, supra,* was based on an agreement which gave the bank the option of setoff under certain specified contingencies.

In Louisiana, the claim of setoff is treated in civilian terminology as "compensation." Compensation is defined in Article 2207, LSA-Revised Civil Code:

> "When two persons are indebted to each other, there takes place between them a compensation that extinguishes both the debts, in the manner and cases hereafter expressed."

Compensation occurs in Louisiana by the mere operation of law even unknown to the debtors. See Article 2208, LSA-Revised Civil Code. Therefore, even if we treated the payroll and general accounts as two entirely separate accounts the defendant would still prevail under the Louisiana provisions for legal compensation, and the credit in one account would be extinguished by the overdraft debit in the other.

Bank of Nevada, supra, was based on the court's rejection of the bank's contention that as a "general rule" a bank has a "general lien" upon deposits. There is no inchoate agreement here, nor is the defendant,

NBC, claiming a general lien under some elusive general rule. The bank asserts a legal right afforded to it by virtue of law and it was not necessary for it to do some positive act in order to perfect this right, for as we have seen in Louisiana Civil Code Article 2208, legal compensation takes place "even unknown to the parties."

We hold that whether the accounts herein are treated separately or as a single account, defendant must prevail. There is no genuine issue of material fact and defendant is entitled to judgment in its favor as a matter of law.

Decree accordingly.

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